STATE OF COLORADO NEIGHBORHOOD STABILIZATION PROGRAM PROGRAM INCOME GUIDE

Prepared for: State of Colorado Department of Local Affairs Division of Housing

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Introduction and Scope

This Guide provides comprehensive reference to the instructions and procedures for Program Income generated by the State of Colorado Neighborhood Stabilization Program (NSP).

Specific instructions are provided for each type of activity that results in program income.

All recipients of NSP awards are responsible for complying with the specific instructions that apply to their NSP grant in carrying out their NSP activities, as well as compliance by entities to which they may make a sub-grant of NSP funds.

The instructions and procedures in this Guide and related documents apply only to the NSP. They differ from program income requirements of other programs in order to respond to the unique program income requirements of the NSP. Program income policies and requirements applicable to other programs administered by the Colorado Division of Housing (CDOH) remain in effect and are not changed or modified by the provisions of this Guide.

The applicable instructions and procedures are incorporated in the Program Performance Plan which is part of the contract between the State of Colorado and the grantee and are enforceable under the terms of that contract.

This Guide may be modified from time to time based on changes in State policy, the NSP statute, or HUD regulations and guidance. The State will promptly notify recipients of changes. The current version of this Guide will be available on the CDOH web site http://www.dola.state.co.us/cdh/NSP.htm

Section 1. Definitions of Program Income

- 1-1 General Principles
- (A) As provided in the NSP Notice, the regulation defining program income at 24 CFR 570.500(a) applies to the NSP.
- (B) All Program Income as specified in this Guide is subject to the provision of 24 CFR 570.500(a)(4) which provides that
 - "Program income does not include:
 - (i) Any income received in a single program year by the recipient and all its subrecipients if the total amount of such income does not exceed \$25,000;

Each recipient will track and aggregate NSP revenue (including revenue received by its subrecipients) on an annual basis. For the NSP, the term "program year" as used in the regulation above means the 12 months period following the NSP program start date specified by the State at the time of grant award. When a recipient receives NSP revenues during a program year that exceeds \$25,000, all such amounts become NSP Program Income.

- (C) In all cases where NSP funds are used for an activity in combination with other funds, the revenue derived from the activity is NSP revenue/program income in proportion that NSP funds represent to the total cost of the activity.
- (D) Grantee Delegation to Sub-Grantee

When a Grantee selects a Sub-Grantee to operate any part of its NSP activities on its behalf, it will pass on to the Sub-Grantee all applicable requirements for Program Income that apply to the Grantee.

- 1-2 Program Income NSP Activity Type
- (A) Financing Mechanisms (NSP Section 2301(c)(3)(A))

As stated in the NSP Notice, this activity is defined as:

Establish financing mechanisms for purchase and redevelopment of foreclosed upon homes and residential properties, including such mechanisms as soft-seconds, loan loss reserves, and shared-equity loans for low- and moderate-income homebuyers

Program Income – NSP funds used as a financing mechanism may generate repayment on a recurring or one time basis. A recurring payment occurs when the financing

mechanism provides for periodic payment of principal, and interest where applicable. One time payments occurs when the NSP financing is due on sale or other stipulated event (recapture of down payment assistance under specified terms).

All principal and interest paid on NSP Financing Mechanism is Program Income.

NOTE: There is no time limit on Program Income generated from an NSP financing mechanism. Program Income received from any Financing Mechanism activity will be returned to the State for use under the terms of its NSP Substantial Amendment.

Where NSP funds are approved for use as a Loan Guarantee, the State will provide separate instructions regarding possible Program Income.

(B) Acquisition – Rehabilitation – Sale/Rent (NSP Section 2301(c)(3)(B))

As stated in the NSP Notice, this activity is defined as:

Purchase and rehabilitate homes and residential properties that have been abandoned or foreclosed upon, in order to sell, rent, or redevelop such homes and properties

Program Income – [PI under (B) is time sensitive; sections – one on resale to owner occupant – note limit on resale amount; all receipts are PI; another section when property rented – use example from HUD PI guidance, adding clarification for debt service – PI includes both principal and interest on a NSP loan, as well as proportional share of residual receipts, e.g. net cash flow after debt service; for rental, also need to ensure reasonable amounts for management fee, replacement reserve and operating reserve; also note when original purchaser sells to another entity and rental continues]

1. Property Sold to Owner Occupant

Net proceeds from the sale of NSP acquired property is Program Income. Grantees will report and document program income following instructions in Section 3 of this Guide

Note: The price of NSP property sold to an owner occupant must be no more than "an amount equal to or less than the cost to acquire and redevelop or rehabilitate such home or property up to a decent, safe, and habitable condition." (NSP Section 2301(d)(3))

2. Property Held for Rental Housing

The Cash Flow on NSP acquired property (as described in Exhibit 1-1 below is Program Income.

If the Grantee subsequently sells rental property, the proceeds of the sale are Program Income. The State will allocate the proceeds depending on whether the Program Income is generated before or after July 30, 2013.

3. Lease Purchase

For the period a property operates as rental housing, Grantees will calculate NSP Program Income following the instructions above. The amount of rent payment set aside as part of the occupant's eventual purchase is not included as rental property income.

When a Grantee sells property under a lease-purchase activity, apply the NSP Program Income definition used in other sales transactions.

4. Redevelopment for Non-Housing Use

If the Grantee sells the property for non-housing use, the proceeds of the sale are NSP Program Income.

If the Grantee holds the property and converts the property to non-housing use (park, open space, community use, etc) any revenue received in excess of operating costs is program income, subject to instructions regarding closeout of the NSP.

Subsequent Sale by Initial Purchaser (purchase from Grantee or Sub-Grantee)

The following applies to sale of NSP financed property by the initial purchaser to an unrelated entity. If the sale is to a related entity, e.g. Subsidiary or single asset entity controlled by the original entity, all program income provisions continue in full force and effect.

Sale by owner occupant – Applicable Recapture/Resale provisions apply; otherwise, proceeds are not Program Income.

Sale of property held for rental – Sale for continued use as rental property – The proceeds from the sale are NSP Program Income. No additional Program Income requirements apply except when specifically included a condition of sale. Sale of Rental to Owner Occupant (not lease-purchase) – proceeds - PI

(C) Land Bank (NSP Section 2301(c)(3)(C))

As stated in the NSP Notice, this activity is defined as:

Establish land banks for homes that have been foreclosed upon

Additional guidance on this activity is included in the following definition in the NSP Notice:

Land bank. A land bank is a governmental or nongovernmental nonprofit entity established, at least in part, to assemble, temporarily manage, and dispose of vacant land for the purpose of stabilizing neighborhoods and encouraging re-use or redevelopment of urban property. For the purposes of the NSP program, a land bank will operate in a specific, defined geographic area. It will purchase properties that have been abandoned or foreclosed upon and maintain, assemble, facilitate redevelopment of, market, and dispose of the land-banked properties. If the land bank is a governmental entity, it may also maintain abandoned or foreclosed property that it does not own, provided it charges the owner of the property the full cost of the service or places a lien on the property for the full cost of the service.

Program Income – Revenue may be generated from a Land Bank activity under two circumstances.

Revenue from the sale of property held in a Land Bank – When a Land Bank sells property acquired in whole or part with NSP funds, **the proceeds of the sale are NSP Program Income** in the same proportion as NSP funds used for the acquisition.

Acquisition Total Cost \$200,000

NSP \$150,000 (75%) Other 50,000 (25%)

Sales Proceeds \$100.000

NSP Program Income \$75,000 (75%) Other \$25,000 (25%)

The Land Bank entity will follow the procedures described in this Guide under "Program Income from Sales Transactions."

Revenue received while property is held by the Land Bank entity:

NSP funds allocated for on-going expenses – Generally:

Revenue received is an "applicable credit" that reduces the amount of NSP funds allocable for on-going expenses (see Allocable Credits" below). As such, this revenue is **NOT Program Income**.

NSP Funds allocated for on-going expenses \$2,500 Temp rent revenue (allocable credit) \$500 On-going expenses allocable to NSP \$2,000

Exception – If the revenue received is more than the amount of NSP funds for on-going expenses, the excess amount **IS** Program Income. For example:

NSP Funds allocated for on going expenses	\$2	2,500
Temp rent revenue	\$3	3,000
NSP program income	\$	500
On-going expenses allocable to NSP	\$	0

In this example, the first \$2,500 of revenue would be an applicable credit thus reducing the allocable NSP funds for on-going expenses to \$0.

NSP not used for on-going expenses:

Revenue received will be used first in accordance with the terms and conditions specified by the entity providing funds for on-going expenses.

If the Land Bank receives revenue in excess of ongoing expenses for an NSP financed Land Bank activity, the excess revenue is NSP Program Income based on the proportion of NSP funds were used to acquire the property.

Acquisition cost	100% NSP
Excess revenue	\$500
NSP Program Income	\$500

Acquisition cost 80% NSP

Excess revenue \$500 NSP program income \$400

The Land Bank entity will follow the procedures described in this Guide under "Program Income – Other."

NOTE: The HUD NSP Notice specifies that a Land Bank may not hold property for more than 10 years. However, there is no other time limit on Program Income generated from an NSP Land Bank. Program Income received from any Land Bank activity will be returned to the State for use under the terms of its NSP Substantial Amendment.

(D) Demolition (NSP Section 2301(c)(3)(D))

As stated in the NSP Notice, this activity is defined as:

Demolish blighted structures

Program Income – In general, NSP demolition activities will not result in program income. Where the demolition includes an allowance for the salvage value of materials, the salvage value is an "applicable credit" (NOT program income) that will reduce the

expense allocable to the NSP (see "Applicable Credits" below). An example of a typical transaction is illustrated as follows:

Demolition Costs	
Gross contract amount	\$15,000
Salvage value – Credit	\$1,000
Net demolition cost	\$14,000
Eligible NSP cost	\$14,000

(E) Redevelopment (NSP Section 2301(c)(3)(E))

As stated in the NSP Notice, this activity is defined as:

Redevelop demolished or vacant properties

Activities funded under this activity may not include the redevelopment for use other than housing.¹

Program Income – All provisions specified in (B) above apply to NSP Redevelopment activities.

1-3 Applicable Credits

Items defined as an "applicable credit" are NOT program income. Applicable credits, as identified in this Guide, are "receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards" (2 CFR Part 225—Cost Principles For State, Local, And Indian Tribal Governments (OMB Circular A–87, Appendix A. C. 4. Applicable Credits). As such, an entity that receives a credit in the implementation of an NSP activity will apply such credit to reduce its request for NSP funds.

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¹ ARRA amended HERRA as follows: "That funding used for section 2301(c)(3)(E) of the Act shall be available only for the redevelopment of demolished and vacant properties as housing."

Exhibit 1-1 Program Income from NSP Rental Project

The following example illustrates revenues that are considered NSP Program Income. [Note: The example is based on the DOH application format (10 year Operating Pro Forma worksheet), adjusted for NSP purposes omitting information related to Low Income Housing Tax Credits]

Rent Income	\$1,000	
Less Vacancy	\$50	
Other Income	\$10	
Effective Gross Income	\$960	
Total Annual Expenses -	\$760	
Includes all reasonable fees and		
payments to operating and		
replacement reserves		
NET OPERATING INCOME	\$200	
Debt Service on NSP financing	\$50	NSP PROGRAM INCOME
(if any)		
Other Debt Service	\$50	
Total Debt Service	\$100	
Cash flow Available	\$100	NSP PROGRAM INCOME
		Proportion of total based on
		proportion of NSP funding to
		total project development cost

Section 2 General Policies

2-1 State Receipt of All Program Income

All Program Income will be returned to CDOH in a timely manner following the procedures and instructions in this Guide. CDOH will allocate Program Income under the provisions of its NSP Plan as described in the NSP Consolidated Plan Amendment.

2-2 Program Income and Eligible NSP Activity Category

Grantees and Sub-Grantees will identify and track all expenditures and revenues that may be Program Income according to its eligible NSP activity.

2-3 Time Sensitive Program Income

Program Income derived from activities identified in 1-2 (B) Acquisition – Rehabilitation – Sale/Rent, and 1-2(E) Redevelopment

Program Income derived from these activities is time sensitive. Program Income received up to July 30, 2013 may be reinvested in additional NSP activities. Program Income that meets the definition of "Profits" (revenues "in excess of the cost to acquire and redevelop or rehabilitate an abandoned or foreclosed-upon home or residential property") may be retained if HUD approves a request to use the funds for other NSP purposes. CDOH intends to request such a waiver from HUD. Program Income received after July 30, 2013 that does not meet the definition of "Profits" will be returned to the US Treasury as required by statute.

CDOH will separately track Program Income derived from these activities to ensure funds are either reinvested or returned to the US Treasury, as required. CDOH will allocate Program Income eligible for reinvestment under the provisions of its NSP Plan as described in the NSP Consolidated Plan Amendment.

2-4 Other Program Income

Program Income derived from activities identifies in 1-2 (A) Financing Mechanisms, 1-2 (C) Land Bank, and 1-2 (C) Demolition

There is currently no time limit on the reinvestment of Program Income derived from these activities. CDOH will allocate Program Income eligible for reinvestment under the provisions of its NSP Plan as described in the NSP Consolidated Plan Amendment.

Section 3 Program Income from Sales Transactions

3-1 Timely Notification

Grantees and their Sub-Grantees will notify CDOH of scheduled closing on the sale of property acquired with NSP funds at least 30 working days ion advance of the scheduled closing date.

Provide Notice of changes in the closing date as on as practicable.

3-2 Calculation of Program Income

Grantees and Sub-Grantees will use the Sales Proceeds Distribution worksheet to identify Program Income due to CDOH from the property sold. Grantees and Sub-Grantees will enter grant information, complete Section 1. and provide the worksheet to the closing agent. The closing agent will complete Section 2.

3-3 Remittance of Program Income

Refer to instructions for each specific type of activity.

Section 4 Program Income from Rental Property

4-1 Program Income from the Financing of Rental Property

Program income from the financing of rental property will be received according to the terms of that financing. In any month that the Grantee or Sub-Grantee receives Program Income (principal and/or interest on the NSP financing) the funds are due to CDOH by the 10th day of the following month.

4-2 Program Income from the Operation of Rental Property

Exhibit 1-1 of this Guide identifies Program Income from the operation of rental property. The Program income amount will be determined annually based on the operating period for each rental property.

Grantees will complete (or obtain from its Sub-Grantees) the Rental Property – Annual Financial Summary for each NSP assisted rental property. The Annual Financial Summary and any Program Income identified is due to CDOH no later than 45 days after the end of the annual operating period.

Section 5 Program Income - Other

Cover both regular (Financing Mechanisms) and sporadic, intermittent ${\sf PI}-{\sf e.g.}$ Land Bank

Section 6 Tracking and Reporting

The Division of Housing (DOH) has a system in place to effectively account for and manage all program income earned as a result of NSP supported activities.

Report Timing and Frequency

Sales Transactions

Report and remit program income for each sale within 3 working days of each closing

Operation of Rental Property

Report and remit program income annually with 45 days of the end of the operating year for each rental property

Other Program Income

In any month in which other program income received, report and remit program income by the 10th day of the following month

Program Income Summary Data

Include program income summary data in the quarterly Financial Status Report due the 15th day following the end of each quarter

In addition to transaction specific data provided by closing agents, NSP Grantees will provide monthly reports to DOH. This information is required from all agencies that have had or are currently receiving funds for any NSP activity. The completed "Monthly Program Income Summary" is due on the 10th day of each month providing data on the previous month.

General Reporting Requirements:

- NSP Expenditures for the previous month, by NSP activity (including administrative expenditures)
- o Total # of properties acquired (closed) during the previous month
- o Total # of properties sold (closed) during the previous month
- o Program Income received during the previous month, by NSP activity
- Race/Ethnicity of Beneficiaries of households served (purchasers or renters) for the previous month.
- o Income levels (breakdown as specified) of beneficiaries by report month.
- Annual agency audit due no later than _____ after the end of the agency's operating year.

CDOH requires that a completed Financial Status Report be submitted quarterly. There is a block on the form for signature by the certifying official that the report is accurate. Upon receipt of the financial report, CDOH will review it for accuracy and consistency with other available information, including grant agreement, and audit reports to ensure that program income is accounted for and the total amount expended is shown.

The recordkeeping requirements governing the NSP state that all records are kept at the local level, including family eligibility and all supporting documentation, and retained for three years from close-out of the NSP contract.

Section 7 Cash Management Procedures

7-1 The NSP Program Notice N. 3. states:

"Cash management. Substantially all program income must be disbursed for eligible NSP activities before additional cash withdrawals are made from the U.S. Treasury."

- 7-2 The State will ensure compliance with this requirement through centralized management of NSP program income receipts. NSP program income will be transmitted to the State of Colorado NSP program income account using the procedures specified in this Guide.
- 7-3 Grantees will use the Pay Request form (NSP version) to request NSP funds from the State. Pay requests must include specified documentation to support all requested funds.
- 7-4 For each withdrawal of cash to meet NSP expenditure requests, available program income will be deducted from the total amount required, with the cash request from the U.S. Treasury NSP account representing the balance of the total amount of the expenditure requests, if any.
- 7-5 Program Income received by a Grantee or Sub-Grantee will be promptly transferred to the State Program Income account in a timely manner as provided in this Guide.

Exhibit 7-1 The following illustrates cash management procedures.

Transaction	US Treasury	State PI Account(s)		STATE		NSP Grantee
1		\$0 ◆		Request to US Treas. \$100,000	4	Grantee A - Request to State \$100,000
	Pay State \$100,000	\$0	-	State to Grantee A \$100,000		Receive and disburse \$100,000
2		\$50,000		Deposit PI	-	Grantee B transfer to State \$50,000 PI
3		\$50,000		b. Request to US Treas. \$50,000	-	Grantee C Request to State \$100,000
	Pay to State \$50,000	\$50,000	—	State to Grantee C \$50,000 PI \$50,000	-	e. Receive and disburse \$100,000
		Balance \$0				

Appendices - Reference And Guide Form Documents

Appendix 1 Contract Program Income Provisions

Exhibit B

2.1.7

Program income is revenue as defined in the Neighborhood Stabilization Program statute, Title III, Division B of the Housing and Economic Recovery Act of 2008 (Public Law 110-289, as amended) and Section II. N. of the implementing Notice (73 FR 58330, October 6, 2008, or as may be amended). Grantees will follow the State's implementing instructions for the tracking, accounting, and use of program income.

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Program income is revenue as defined in the Neighborhood Stabilization Program statute, Title III, Division B of the Housing and Economic Recovery Act of 2008 (Public Law 110-289, as amended) and Section II. N. of the implementing Notice (73 FR 58330, October 6, 2008, or as may be amended). Grantees will follow the State's implementing instructions for the tracking, accounting, and use of program income.

Appendix 2 NSP Statutory Provision

HR 3221 (PL 110-289) - DIVISION B - TITLE III EMERGENCY ASSISTANCE FOR THE REDEVELOPMENT OF ABANDONED AND FORECLOSED HOMES

SEC. 2301. EMERGENCY ASSISTANCE FOR THE REDEVELOPMENT OF ABANDONED AND FORECLOSED HOMES.

- (d) LIMITATIONS.—
- (4) REINVESTMENT OF PROFITS.—
 - (A) PROFITS FROM SALES, RENTALS, AND REDEVELOPMENT.—
 - (i) 5-YEAR REINVESTMENT PERIOD.—During the 5-year period following the date of enactment of this Act, any revenue generated from the sale, rental, redevelopment, rehabilitation, or any other eligible use that is in excess of the cost to acquire and redevelop (including reasonable development fees) or rehabilitate an abandoned or foreclosed upon home or residential property shall be provided to and used by the State or unit of general local government in accordance with, and in furtherance of, the intent and provisions of this section. (ii) DEPOSITS IN THE TREASURY.—
 - (I) PROFITS.—Upon the expiration of the 5-year period set forth under clause (i), any revenue generated from the sale, rental, redevelopment, rehabilitation, or any other eligible use that is in excess of the cost to acquire and redevelop (including reasonable development fees) or rehabilitate an abandoned or foreclosed upon home or residential property shall be deposited in the Treasury of the United States as miscellaneous receipts, unless the Secretary approves a request to use the funds for purposes under this Act.
 - (II) OTHER AMOUNTS.—Upon the expiration of the 5-year period set forth under clause (i), any other revenue not described under subclause (I) generated from the sale, rental, redevelopment, rehabilitation, or any other eligible use of an abandoned or foreclosed upon home or residential property shall be deposited in the Treasury of the United States as miscellaneous receipts.
 - (B) OTHER REVENUES.—Any revenue generated under subparagraphs (A), (C) or (D) of subsection (c)(3) shall be provided to and used by the State or unit of general local government in accordance with, and in furtherance of, the intent and provisions of this section.

Deleted – Title XII, Division A, ARRA of 2009

Appendix 3 NSP Notice

N. Alternative Requirement for Program Income (Revenue) Generated by Activities Assisted With Grant Funds

Requirement

Revenue received by a state, unit of general local government, or subrecipient (as defined at 24 CFR 570.500(c)) that is directly generated from the use of CDBG funds (which term includes NSP grant funds) constitutes CDBG program income. To ensure consistency of treatment of such revenue, the definition of program income at 24 CFR 570.500(a) shall be applied to amounts received by states, units of general local government, and subrecipient. However, Section 2301(d)(4) imposes certain limitations and requirements that necessitate an alternative requirement to govern the use of program income generated by activities carried out pursuant to Section 2301(c). The limitations and requirements are based on the NSP activity that generated the program income and on the date the income is received. In addition, Section 2301(d)(4) requires any revenue from the sale, rental, redevelopment, rehabilitation or any other eligible use of NSP funds to be provided to and used by the state or unit of local general government. This includes revenue received by a private individual or other entity that is not a subrecipient.

- 1. Program income generated by activities carried out pursuant to Section 2301(c)(3)(B) and (E).
- a. Program income received before July 30, 2013, may be retained by the state or unit of general local government if it is treated as additional CDBG funds and used in accordance with the requirements of Section 2301.
- b. Program income received on or after July 30, 2013—Return to the Treasury.²

Any program income received by a state, unit of general local government, or subrecipient on or after July 30, 2013, that is generated by activities carried out pursuant to Section 2301(c)(3)(B) and (E) (e.g., proceeds from the sale of rental housing by a state, unit of general local government, or subrecipient) and is not authorized to be retained as described below must be remitted to HUD for deposit in the Treasury. Any program income received by a state, unit of general local government, or subrecipient on or after July 30, 2013, that is generated by activities carried out pursuant to Section 2301(c)(3)(B) and (E) and that is in excess of the cost to acquire and redevelop or rehabilitate an abandoned or foreclosed-upon home or residential property may be retained if HUD approves a request to use the funds for other NSP purposes. Note that no profit can be earned on the sale of an abandoned or foreclosed-upon home or residential property to an individual as a primary residence; as provided under Section 2301(c)(3), the sale must be in an amount equal to or less than the cost to acquire and redevelop or rehabilitate the home or property up to a decent, safe, and habitable condition.

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² This section 1.b. rendered inapplicable by repeal of section 2301(d)(4) by ARRA

Example: A unit of general local government acquires a foreclosed-upon multi-family residential property for \$100,000, spends \$100,000 to redevelop the property, and sells the property for \$225,000. If the sale occurs on or after July 30, 2013, the amount to be remitted to HUD by the state or unit of general government is \$200,000 if HUD authorizes the profit of \$25,000 to be used for other NSP purposes, or \$225,000 if HUD does not authorize such use.

- c. Revenue received by a private individual or other entity that is not a subrecipient.
- i. Any revenue generated by activities carried out pursuant to Section 2301(c)(3)(B) and (E) that is in excess of the cost to acquire and redevelop (including reasonable development fees) or rehabilitate an abandoned or foreclosed-upon home or residential property must be provided to the state or unit of general local government and treated as program income. The disposition of the program income by the state or unit of general local government is governed by a. and b. above.
- ii. Any revenue that is generated by activities carried out pursuant to Section 2301(c)(3)(B) and (E) and is received on or after July 30, 2013, shall be provided to the State or unit of general local government and treated as program income. The disposition of the program income by the state or unit of general local government is governed by b. above.

Example: A unit of general local government uses NSP funds to make a loan (or grant) to a developer to finance the acquisition and rehabilitation of a foreclosed upon multifamily residential property. The developer uses \$200,000 in NSP funds (loan or grant) from the unit of general local government to pay the total costs of acquisition and rehabilitation (including reasonable development fees) and subsequently sells the property for \$225,000. The developer is required to provide \$225,000 to the unit of general local government. (If the NSP funding was a loan, the sale proceeds would be used to repay the NSP loan.) If the sale occurs on or after July 30, 2013, the unit of general local government must remit \$225,000 to HUD for deposit in the United States Treasury, unless HUD approves a request to use \$25,000 of that amount for other NSP purposes. If in this same example, the developer received \$100,000 of NSP funding and used \$100,000 of its own funds for eligible costs, the revenue to be provided to the local government would be \$125,000.

- 2. Program income generated by activities carried out pursuant to Section 2301(c)(3)(A), (C) and (E). Program income received may be retained by the State or unit of general local government if it is treated as additional CDBG funds and used in accordance with the requirements of Section 2301. Revenue received by a private individual or other entity that is not a subrecipient must be returned to the State or unit of general local government.
- 3. Cash management. Substantially all program income must be disbursed for eligible NSP activities before additional cash withdrawals are made from the U.S. Treasury.

4. Agreements with subrecipients and other entities. States and units of general local governments must incorporate in subrecipient agreements such provisions as are necessary to ensure compliance with the requirements of this paragraph, including the requirement that program income described in N.1.(b) be remitted to HUD for deposit in the Treasury. States, units of general local government, and subrecipients must incorporate in agreements with private individuals and other entities that are not subrecipients such provisions as are necessary to ensure compliance with the requirements governing disposition of revenue generated by activities carried out pursuant to Section 2301(c).

NOTE: Eligible uses as referenced

- (A) establish financing mechanisms for purchase and redevelopment of foreclosed upon homes and residential properties, including such mechanisms as soft-seconds, loan loss reserves, and shared-equity loans for low- and moderate- income homebuyers;
- (B) purchase and rehabilitate homes and residential properties that have been abandoned or foreclosed upon, in order to sell, rent, or redevelop such homes and properties;
- (C) establish land banks for homes that have been foreclosed upon;
- (D) demolish blighted structures; and
- (E) redevelop demolished or vacant properties.

Appendix 4 CDBG Entitlement Program Income Regulations

Sec. 570.500 Definitions.

Source: 53 FR 8058, Mar. 11, 1988, unless otherwise noted.

For the purposes of this subpart, the following terms shall apply:

- (a) Program income means gross income received by the recipient or a subrecipient directly generated from the use of CDBG funds, except as provided in paragraph (a)(4) of this section.
- (1) Program income includes, but is not limited to, the following:
 - (i) Proceeds from the disposition by sale or long-term lease of real property purchased or improved with CDBG funds;
 - (ii) Proceeds from the disposition of equipment purchased with CDBG funds;
 - (iii) Gross income from the use or rental of real or personal property acquired by the recipient or by a subrecipient with CDBG funds, less costs incidental to generation of the income:
 - (iv) Gross income from the use or rental of real property, owned by the recipient or by a subrecipient, that was constructed or improved with CDBG funds, less costs incidental to generation of the income;
 - (v) Payments of principal and interest on loans made using CDBG funds, except as provided in paragraph (a)(3) of this section;
 - (vi) Proceeds from the sale of loans made with CDBG funds;
 - (vii) Proceeds from sale of obligations secured by loans made with CDBG funds;
 - (viii) [Reserved]
 - (ix) Interest earned on program income pending its disposition; and
 - (x) Funds collected through special assessments made against properties owned and occupied by households not of low and moderate income, where the assessments are used to recover all or part of the CDBG portion of a public improvement.
- (2) Program income does not include income earned (except for interest described in Sec. 570.513) on grant advances from the U.S. Treasury. The following items of income earned on grant advances must be remitted to HUD for transmittal to the U.S. Treasury, and will not be reallocated under section 106(c) or (d) of the Act:
 - (i) Interest earned from the investment of the initial proceeds of a grant advance by the U.S. Treasury;
 - (ii) Interest earned on loans or other forms of assistance provided with CDBG funds that are used for activities determined by HUD either to be ineligible or to fail to meet a national objective in accordance with the requirements of subpart C of this part, or that fail substantially to meet any other requirement of this part; and
 - (iii) Interest earned on the investment of amounts reimbursed to the CDBG program account prior to the use of the reimbursed funds for eligible purposes.
- (3) The calculation of the amount of program income for the recipient's CDBG program as a whole (i.e., comprising activities carried out by a recipient and its subrecipients) shall exclude payments made by subrecipients of principal and/or interest on CDBG-funded loans received from grantees if such payments are made using program income received by the subrecipient. (By making such payments, the subrecipient shall be deemed to have transferred program

income to the recipient.) The amount of program income derived from this calculation shall be used for reporting purposes, for purposes of applying the requirement under Sec. 570.504(b)(2)(iii), and in determining limitations on planning and administration and public services activities to be paid for with CDBG funds.

(4) Program income does not include:

- (i) Any income received in a single program year by the recipient and all its subrecipients if the total amount of such income does not exceed \$25,000; and
- (ii) Amounts generated by activities that are financed by a loan guaranteed under section 108 of the Act and meet one or more of the public benefit criteria specified at Sec. 570.209(b)(2)(v) or are carried out in conjunction with a grant under section 108(g) in an area determined by HUD to meet the eligibility requirements for designation as an Urban Empowerment Zone pursuant to 24 CFR part 597, subpart B. Such exclusion shall not apply if CDBG funds are used to repay the guaranteed loan. When such a guaranteed loan is partially repaid with CDBG funds, the amount generated shall be prorated to reflect the percentage of CDBG funds used. Amounts generated by activities financed with loans guaranteed under section 108 which are not defined as program income shall be treated as miscellaneous revenue and shall not be subject to any of the requirements of this part, except that the use of such funds shall be limited to activities that are located in a revitalization strategy area and implement a HUD approved area revitalization strategy pursuant to Sec. 91.215(e) of this title. However, such treatment shall not affect the right of the Secretary to require the section 108 borrower to pledge such amounts as security for the guaranteed loan. The determination whether such amounts shall constitute program income shall be governed by the provisions of the contract required at Sec. 570.705(b)(1).
- (5) Examples of other receipts that are not considered program income are proceeds from fund raising activities carried out by subrecipients receiving CDBG assistance (the costs of fundraising are generally unallowable under the applicable OMB circulars referenced in 24 CFR 84.27), funds collected through special assessments used to recover the non-CDBG portion of a public improvement, and proceeds from the disposition of real property acquired or improved with CDBG funds when the disposition occurs after the applicable time period specified in Sec. 570.503(b)(8) for subrecipient-controlled property, or in Sec. 570.505 for recipient-controlled property.

NEIGBORHOOD STABILIZATION PROGRAM GUIDANCE ON PROGRAM INCOME & REVENUE REQUIREMENTS

INTRODUCTION

This guidance is provided for states, units of general local government, subrecipients, and other entities that receive revenue directly generated by activities carried out with NSP funds. When such revenue is received by a state, unit of general local government, or subrecipient (as defined at 24 CFR 570.500(c)), it is referred to as *Program Income*. When such revenue is received by an individual or other entity (e.g., a developer of a housing project), it is referred to as *Revenue*.

Part A provides guidance on how to determine whether revenue received by a state, unit of general local government, or subrecipient is program income and, thus, subject to the NSP requirements. Part B provides guidance on revenue received by individuals or other entities that are not subrecipients. Part C provides guidance on how states and units of general local government must use program income (including revenue returned to them by individuals or other entities that are not subrecipients).

PART A: IS IT PROGRAM INCOME?

STEP ONE: DID THE STATE, UNIT OF GENERAL LOCAL GOVERNMENT, OR SUBRECIPIENT RECEIVE REVENUE THAT WAS DIRECTLY GENERATED FROM THE USE OF NEIGHBORHOOD STABILIZATION PROGRAM (NSP) FUNDS AND DOES THIS REVENUE FALL WITHIN THE DEFINITION OF PROGRAM INCOME AT 24 CFR 570.500(a)(1)?

EXAMPLES OF NSP PROGRAM INCOME:

- Proceeds from the sale or lease of property acquired/redeveloped/rehabilitated with NSP funds
- ➤ Principal and interest payments on loans made from NSP funds
- Revenue returned by individuals or other entities that are not subrecipients (see examples in Part B)
- > Recaptures on sales of homes pursuant to enforcement of NSP affordability requirements
- > (See §570.500(a)(1) for more examples of amounts that are treated as program income.)
 - □ YES, Go to Step Two.
 - □ NO, Stop here. This revenue IS NOT program income.

STEP TWO: IS THIS TYPE OF REVENUE LISTED IN THE PROGRAM INCOME EXCLUSIONS AT §570.500(a)(2), (a)(4), and (a)(5)?

EXAMPLES:

- ➤ Interest earned on advances of NSP grants from the U.S. Treasury
- > Interest earned on loans of NSP funds that finance activities that are either ineligible or fail to meet a HUD national objective
- > Funds collected through special assessments used to recover the non-NSP portion of the cost of a public improvement
 - □ YES, Stop here. This revenue IS NOT program income; however, the interest earned on grant advances or ineligible loans must be remitted to HUD.
 - □ NO, Go to Step Three.

STEP THREE: WAS THE ACTIVITY THAT DIRECTLY GENERATED THE REVENUE FINANCED IN WHOLE WITH NSP FUNDS?

- □ YES. All revenue must be used in accordance with Part C.
- □ NO. A portion of the revenue must be used in accordance with Part C based on the NSP participation in the funding of the activity generating the revenue (e.g., if 25% of the costs of the activity was paid with NSP funds, then 25% of the revenue must be returned to the State or Unit of General Local Government).

PART B: IS IT REVENUE RECEIVED BY PRIVATE INDIVIDUALS/ENTITIES THAT ARE NOT SUBRECIPIENTS?

STEP ONE: DID THE PRIVATE INDIVIDUAL/ENTITY RECEIVE REVENUE THAT WAS DIRECTLY GENERATED FROM THE USE OF NEIGHBORHOOD STABILIZATION PROGRAM (NSP) FUNDS AND DOES THIS REVENUE FALL WITHIN THE DEFINITION OF PROGRAM INCOME AT 24 CFR 570.500(a)(1)?

EXAMPLES OF NSP REVENUE:

- Proceeds from the sale or lease of property acquired/redeveloped/rehabilitated with NSP funds
- ➤ Principal and interest payments on loans made from NSP funds (e.g., payments on purchase money mortgage loans)
- > Net operating income from operation of rental properties acquired and/or rehabilitated with NSP funds
- (See §570.500(a)(1) for more examples of amounts that are treated as NSP revenue)
- □ YES, Go to Step Two.
- □ NO, Stop here. This revenue IS NOT subject to NSP requirements.

STEP TWO: WAS THE ACTIVITY THAT DIRECTLY GENERATED THE REVENUE FINANCED IN WHOLE WITH NSP FUNDS?

- □ YES. All revenue must be returned to the State or Unit of General Local Government and used in accordance with Part C.
- □ NO. A portion of the revenue must be returned to the State or Unit of General Local Government based on the NSP participation in the funding of the activity generating the revenue (e.g., if 50% of the costs of the activity was paid with NSP funds, then 50% of the revenue must be returned to the State or Unit of General Local Government).

EXAMPLE: A grantee uses NSP funds to make a loan (or a grant) to a private individual/entity to finance the acquisition and rehabilitation of a foreclosed-upon multifamily residential property. The private individual/entity uses \$200,000 in NSP funds (loan or grant) from the grantee to pay the total costs of acquisition and rehabilitation (including reasonable development fees) and then sells the property for \$225,000. The private individual/entity must provide \$225,000 to the grantee. (If the NSP funding was a loan, the sales proceeds would be used to repay the NSP loan.) If in this same example, the private individual/entity received \$100,000 in NSP funds, and used \$100,000 of its own funds, the program income to be provided to the grantee would be \$112,500.

EXAMPLE: A grantee uses \$250,000 in NSP funds to make a loan (or a grant) to a private individual/entity to finance the acquisition and rehabilitation of a foreclosed-upon multifamily residential property. The private individual/entity utilizes \$500,000 of its own resources in conjunction with the \$250,000 in NSP funds, for a total development cost of

\$750,000. The private individual/entity must return to the grantee a portion of the "net operating income" generated by the project, as calculated below. This percentage will be based on the percentage of the total development cost of the project.

Rental Income

Gross Annual Rental Income	120,000
Less (-) 5% Vacancy	(6,000)
Plus (+) Other Income	-

Total Effective Income:

114,000

Operating	Expenses
Opolating	

Management Fee	12,000
Utilities	24,000
Maintenance	15,000
Grounds and Landscaping	10,000
Insurance	4,200
Real Estate Tax	4,800
Replacement Reserves	10,000
Pest Control	3,000
Other Expenses	1,000

Total Operating Expenses:

84,000

Net Operating Income (NOI):

30,000

In this example, NSP funds were used to pay one-third of the total development cost. Consequently, since the Net Operating Income was \$30,000, the private individual/entity must return \$10,000 (i.e., one-third) to the grantee.

PART C: USE OF PROGRAM INCOME RECEIVED BY STATE OR UNIT OF GENERAL LOCAL GOVERNMENT

NOTE: The NSP Notice published in the *Federal Register* on October 6, 2008, imposes certain limitations and requirements with respect to NSP program income that are based on the eligible use category of Section 2301(c)(3) and the date the income is received. Before proceeding with this Part C, the reader should determine the eligible use category under which the activity generating the program income was carried out and whether the income was received before July 30, 2013. Eligible use categories of Section 2301(c)(3) are listed below.

- ➤ (A) Establish financing mechanisms for purchase and redevelopment of foreclosed upon homes and residential properties, including such mechanisms as soft-seconds, loan loss reserves, and shared-equity loans for low- and moderate-income homebuyers.
- ➤ (B) Purchase and rehabilitate homes and residential properties that have been abandoned or foreclosed upon, in order to sell, rent, or redevelop such homes and properties.
- (C) Establish land banks for homes that have been foreclosed upon.
- > (D) Demolish blighted structures.
- > (E) Redevelop demolished or vacant properties.

STEP ONE: WAS THE PROGRAM INCOME GENERATED BY ACTIVITIES CARRIED OUT PURSUANT TO ELIGIBLE USE CATEGORY (A), (C), OR (D), AS DESCRIBED ABOVE?

- □ YES, Stop here. The State or Unit of General Local Government may retain this program income if it is treated as additional CDBG funds and used in accordance with Section 2301.
- □ NO, The program income was generated by activities carried out pursuant to eligible use category (B) or (E) of Section 2301(c)(3). Go to Step Two.

STEP TWO: WAS THE PROGRAM INCOME RECEIVED PRIOR TO JULY 30, 2013?

- □ YES, Stop here. The State or Unit of General Local Government may retain this program income if it is treated as additional CDBG funds and used in accordance with Section 2301.
- □ NO, Go to Step Three.

STEP THREE: DID THE STATE OR UNIT OF GENERAL LOCAL GOVERNMENT RECEIVE REVENUE ON OR AFTER JULY 30, 2013 (INCLUDING REVENUE RETURNED BY AN INDIVIDUAL OR OTHER ENTITY THAT IS NOT A SUBRECIPIENT), THAT IS IN EXCESS OF THE COST TO ACQUIRE AND REDEVELOP OR REHABILITATE AN ABANDONED OR FORECLOSED-UPON HOME OR RESIDENTIAL PROPERTY?

□ YES, Stop here. The State or Unit of General Local Government may retain and utilize such revenues for other NSP purposes, upon written approval from HUD.

□ NO, Go to Step Four.

STEP FOUR: WAS PROGRAM INCOME, OTHER THAN THE PROGRAM INCOME DESCRIBED IN STEP THREE, RECEIVED ON OR AFTER JULY 30, 2013?

- □ YES, Stop here. The State or Unit of General Local Government must remit all such program income to HUD
- □ NO, Stop here.

EXAMPLE: A grantee acquires a foreclosed-upon property for \$100,000, spends \$100,000 to redevelop the property, and sells the property for \$225,000. (The buyer is NOT an individual that will use the property as a primary residence.) If the sale occurs on or after July 30, 2013, the amount to be remitted to HUD by the grantee is \$200,000 if HUD authorizes the profit of \$25,000 to be used for other NSP purposes, or \$225,000, if HUD does not authorize such use.

PROGRAM INCOME

The Federal Register Notice discussion on program income says that the sale of property must be in an amount equal to or less than the cost to acquire and redevelop or rehabilitate the home or property, but the example talks about a \$25,000 profit. How can there be profits if the sale must be in an amount equal to or less than the acquisition cost?

It is true that in some circumstances the sale of a property will not generate a profit, but there is a vital distinction. The requirement regarding the sale price has to do with selling a property to someone for use as their residence (see Notice section J). The example cited in the Federal Register Notice question concerns program income requirements, and it talks about selling a multifamily building (such as a rental property), but the example does not talk about selling individual units to individual homeowners; it talks about selling the entire building. Nothing prohibits selling a residential building to an investor, developer or a nonprofit for a profit.

If an NSP grantee uses both NSP and CDBG funds to acquire and rehabilitate a property, how do you prorate the program income and in this situation can profits be generated?

The proration is based on the amount of NSP and regular CDBG funds used. For example, if an entitlement community buys a property for \$10,000, rehabilitates it for \$10,000, and then sells it for \$22,000 (assuming the sale is not to an individual for use as a primary residence). The cost of acquisition and rehabilitation is paid with NSP funds (75%) and entitlement funds (25%). The NSP program income is \$16,500 (75% of \$22,000) and regular CDBG program income is (\$5,500). The profit that is subject to be returned to the Treasury is \$1,500.

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How long do NSP grantees have to track program income on NSP-funded activities?

As stated in the NSP Notice, program income from NSP-funded activities is subjected to limitations and requirements based on the NSP activity that generated the program income and on the date the income is received. Program income received before July 30, 2013, may be retained by the state or unit of general local government if it is used for eligible NSP activities. Program income received on or after July 30, 2013, must be remitted to HUD for deposit in the Treasury unless HUD approves a request to use the funds for other NSP purposes.